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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1968

Nos. 1375 and 1376

WOLF CORPORATION, JOSEPH WOLF, JOSEPH ECKHAUS, LEON SPILKY, DAVID BERDON & Co., and TROSTER, SINGER & Co.,

Petitioners,

against

LEON GREEN,

Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION

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Opinions Below

The opinion of the Court of Appeals for the Second Circuit (App. A of Petition) is reported at 406 F. 2d 291. The opinion of the District Court (App. B of Petition) is unreported.

Jurisdiction

Petitioners (hereinafter "defendants") invoke the jurisdiction of this Court under Title 28 U.S.C., Section 1254(1).

Questions Presented

1. Whether certiorari should be granted to review defendants' claim that there is a conflict of interest precluding a class action because plaintiff-respondent "may not be motivated" to prove deficiencies in all three prospectuses involved in this case where (a) such claim is not only entirely speculative but (b) is interlocutory and (c), moreover, was not even made below.

2. Whether, in any event, defendants' claim of a conflict in interest is meritorious where (a) persons excluded from the instant class will not receive any representation at all in that the statute of limitations has otherwise run and (b) defendants' claim of a conflict is without any basis whatever in the record.

Statutes, Rules and Regulations Involved

The statutes, rules and regulations involved are adequately set forth in the petition at pages 3-6.

Statement

This is a petition for certiorari to review that part of the decision of the Court of Appeals for the Second Circuit holding that the instant action is properly maintainable as a class action pursuant to F.R.C.P. 23 (b) (3). The facts are as follows.

A. The Basic Nature of the Instant Action

The defendant, Wolf Corporation, is a consolidation, under the corporate form, of various real estate limited partnerships syndicated by the Corporation's controlling directors, officers and stockholders, namely, defendants Joseph Wolf, Joseph Eckhaus and/or Leon Spilky, who

were the general partners of these partnerships (22a).* The Corporation first went public in June, 1961 (23a). In January, 1962 the Corporation filed with the Securities and Exchange Commission a second registration statement (23a).

The Corporation's second registration statement, which never became effective, was the subject of stop-order proceedings instituted in September, 1962 by the SEC upon the ground that it was materially misleading (23a). The SEC's stop-order proceedings were concluded by a stipulation of settlement between the Corporation and the SEC which amended the second registration statement by stipulating certain facts and which withdrew the second registration statement as thus amended (24a). In its opinion accepting the Corporation's offer of settlement, the SEC stated that, by virtue of the facts set forth in the stipulation of settlement, "the shareholders of the company and any public investors who may be interested will have available to them the dismal record of the abortive financial program and the deceptive financial presentation of the registrants' earlier record of operations, as reflected in a registration statement and commented upon in this opinion (Ex.** 6, p. 11).

The basic nature of this action is as follows. The Corporation within the period of a year issued three prospectuses (the prospectuses dated June 2, 1961 (Ex. 1), January 26, 1962 (Ex. 2) and June, 1962 (Ex. 3)). Each

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* Record references ending in "a" are to plaintiff-respondent's printed appendix in the court below.

** References in this brief to exhibits are to the exhibits annexed to the affidavit in opposition (21a) (Exs. 1-13) and to the supplemental affidavit in opposition (53a) (Ex. 14) of plaintiff-respondents' counsel submitted in the District Court in opposition to defendants' motions. While the exhibits were not printed, they are part of the record in the court below.

of these prospectuses purported to set forth the Corporation's cash flow. Defendants do not deny that these prospectuses contained the only financial information publicly disseminated by the Corporation in the period from June, 1961 through the end of 1963 which purported to set forth the Corporation's cash flow (54a).

As is well known, the market price of a real estate security is directly related to the cash available for distribution to stockholders (26a). Respondent's (hereinafter "plaintiff") contention is that the Corporation's prospectuses grossly overstated the cash available for distribution to stockholders (21a-22a) and that, indeed, the Corporation's monthly cash distributions to stockholders were substantially in excess of the cash available for such distribution (28a). Nothwithstanding that the Corporation's cash outflow substantially exceeded its cash inflow, the Corporation increased the rate of its monthly cash distributions to stockholders effective January 10, 1962, about two weeks before the Corporation filed its second registration statement with the SEC (26a-28a).

Hence, plaintiff claims that the gross overstatement of cash available for distribution in the Corporation's three prospectuses resulted in artificially and falsely inflating the market price of the Corporation's securities (the Class A common and also the subordinated debentures) in the period from June, 1961 through the end of 1963 (25a-29a, 41a-42a). The market price of the Corporation's Class A common ranged between a bid of 9 and 14 from June, 1961 (when the Corporation first went public) to about September 24, 1962, the date of the institution of the SEC's stop-order proceedings (55a). Thereafter, the Corporation's stock declined in price till it reached a bid of about 1⅛ or 1¼ at the end of 1963 (56a). From the end of 1963 until institution of this action in October, 1966, the price of the Corporation's stock ranged between a bid of 1 and 2½ (56a).

The transaction upon which plaintiff is suing in this action is plaintiff's purchase in the open market of 100 shares of the Corporation's Class A common on June 13, 1962 at 10¼ per share for sum of $1,042.25 (inclusive of commissions) (42a). Plaintiff still held this stock as of the commencement of this action. Plaintiff seeks herein his out-of-pocket loss (not loss of bargain) which, plaintiff claims, is the difference between the market price of 10¼ that he paid for the Corporation's Class A common and the true value, i.e., the unmanipulated value, of the Corporation's Class A common (42a, 56a). Plaintiff's contention is that the true or unmanipulated value of the Corporation's Class A common lies in the range of 1 to 2½ (the approximate price range of the stock since the end of 1963 till the institution of this action in October, 1966 (42a, 56a), it being plaintiff's further contention that the effect of the Corporation's misleading prospectuses on the market price of the stock was not fully dissipated until the end of 1963 (42a, 56a).

Plaintiff brings this action on behalf of himself and also all other persons similarly situated, namely, all persons who purchased for a monetary consideration either the Corporation's Class A common stock or the Corporation's subordinated debentures in the period from June 2, 1961, through the end of 1963 either in the distribution covered by the Corporation's registration statement which became effective on June 2, 1961 or thereafter in the open market (21a). Plaintiff sues on behalf of all such monetary purchasers whether they still hold the Corporation's securities or whether they sold the Corporation's securities at a loss.

The defendants herein, in addition to the Corporation, are the Corporation's controlling directors, officers and stockholders (Joseph Wolf, Joseph Eckhaus, and Leon Spilky); the public accounting firm which certified various finanacial statements contained in the three prospectuses (David Berdon & Co.); and the broker-dealer which

was the underwriter with respect to the Corporation's second registration statement (Troster, Singer & Co.). The complaint alleges (par. 4) that these other defendants controlled and/or aided and abetted the Corporation in artifically and falsely inflating the market price of the Corporation's securities (5a). Troster, Singer is being sued herein only for its connection with the Corporation's June, 1962 prospectus (18a), that is, for the period since June 1, 1962, the date upon which the Corporation's third prospectus (which bears upon the cover page the name of Troster, Singer & Co. as the underwriter) was filed with the SEC (Ex. 3 (June, 1962 P.), p. 1).

B. The Underlying Chronology of Events

The Corporation was formed in January, 1961, acquiring upon its formation several properties from the insider group of defendants Joseph Wolf, Joseph Eckhaus, Leon Spilky and others in exchange for subordinated debentures of the Corporation in the total amount of $775,000 (Ex. 1 (June, 1961, P.), p. 4). Shortly thereafter, on February 15, 1961, the Corporation filed a registration statement with the SEC which became effective on June 2, 1961 (22a). This registration statement covered the Corporation's Class A common stock and also its subordinated debentures (Ex. 1 (June 1961 P.)).

Under this first registration statement, the Corporation sold 60,000 shares of its Class A common stock to the public at the price of $10.00 per share. In addition, the Corporation offered 746,350 shares of its Class A common stock and $2,808,000 of its subordinated debentures in exchange for the interests of the limited partners in nine real estate limited partnerships which had been syndicated by defendants Joseph Wolf, Joseph Eckhaus and/or Leon Spilky, who were the general partners of such partnerships (Ex. 1 (June, 1961 P.), *passim*).

On January 26, 1962, the Corporation filed with the SEC a second registration statement which covered an addi-

tional issue of the Corporation's Class A common stock and its subordinated debentures (Ex. 2 (January 26, 1962 P.)). In June, 1962, the Corporation amended its second registration statement so as to cover a different combination of securities, namely, the Corporation's Class A common stock, as before, and a new issue of convertible debentures (See Ex. 3 (June, 1962 Prospectus)).

By order and notice of hearing dated September 24, 1962 (Ex. 4), the SEC instituted stop-order proceedings against the Corporation's second registration statement upon the ground that it was materially misleading. Hearings before the SEC duly commenced on October 22, 1962 and continued upon various adjourned dates through April 11, 1963 (23a).

During the course of the SEC's hearings, the Corporation and the SEC entered into a stipulation of settlement dated April 16, 1964 (Ex. 5), which stipulated certain facts solely for the purposes of the SEC's proceeding. By order and decision dated May 4, 1966 (Ex. 6), the SEC found that the second registration statement of the Corporation was materally misleading (Ex. 6).

C. The Specific Respects in Which the Prospectuses Were Misleading

The Gross Overstatement of the Cash Available for Distribution to Stockholders

Paragraph 7 of the complaint herein specifies the respects in which the Corporation's three prospectuses were misleading (6a-9a). The essence of the complaint is found in paragraph 7(a), which alleges that the prospectuses failed to disclose that the cash distributions which the Corporation was paying on its Class A common stock were in excess of the cash actually available for distribution to stockholders (6a). The remainder of paragraph 7 constitutes, basically, a bill of particulars.

The complaint further alleges (par. 10) that the misleading prospectuses were widely disseminated in the financial community and caused the offering and market prices of the Corporation's securities (i.e., the Class A common stock and the subordinated debentures) to be artificially and falsely inflated (10a). As noted, defendants do not deny that the prospectuses constituted the only financial information publicly disseminated by the Corporation through the end of 1963 which purported to set forth in the amount of cash available for distribution to stockholders (54a).

As stated in the SEC's decision, "[r]egistrant's ability to maintain distributions at approximately this level [8¢ per month or 96¢ per annum] was of paramount importance to prospective purchasers of its securities" (Ex. 6, p. 3) and that the "primary appeal of cash flow real estate securities lay in the generous returns that they seemed to offer" (Ex. 6, p. 3, footnote 5). And as further stated in the SEC's decision, "[p]rices of cash flow real estate stocks are directly responsive to changes in cash distribution policies" (Ex. 6, p. 9, footnote 22).

The Corporation's first prospectus dated June 2, 1961 projects cash available for distribution to stockholders in the annual amount of $524,631, an amount just sufficient (taking into account waivers of various payments to themselves by defendants Wolf, Eckhaus and Spilky) to pay a cash distribution of 7¢ per month (Ex. 1, p. 15). The Corporation's first prospectus dated June 2, 1961, states that, "it is expected that the Company will be able, and it intends, to make cash distributions for its first fiscal year of at least 84¢ per share to the holders of Class A Common Stock" (Ex. 1, p. 9, lines 12-13 from top).

Commencing January 10, 1962, the Corporation raised the level of its cash distributions from 7¢ to 8¢ per month (Ex. 2 (January 26, 1962 P.), p. 10). On January 26, 1962, the Corporation filed its second registration statement with

the SEC for the purpose of selling additional securities to the public (Ex. 2).

The Corporation's second prospectus dated January 26, 1962 projects cash available for distribution to stockholders in the annual amount of $755,262, an amount just sufficient (again taking into account waivers of various payments to themselves by defendants Wolf, Eckhaus and Spilky) to pay a cash distribution of 96¢ per annum (or 8¢ per month) (Ex. 2, p. 13). The Corporation's second prospectus dated January 26, 1962, states that "[b]ased upon the cash derived from operations . . . the Company adopted the policy of paying cash distributions to the holders of Class A Common Stock at the rate of 84¢ per year upon commencement of operations during June, 1961"; that "[a]fter having distributed 7¢ per month during the first six months of operations the Company raised the distribution per share to 8¢ per month to the holders of Class A Common Stock payable January 10, 1962"; and that "the Company believes that the continued payment of distributions at the rate of 96¢ per share per year may continue to be paid out of operations, refinancing of mortgages, sale of properties or other sources of income to the holders of Class A Common Stock and a distribution of 30¢ per share, if available, may be paid to the holders of Class B Common Stock [the insiders entitled to elect two-thirds of the directors]" (Ex. 2, p. 10).

The Corporation's third prospectus dated June, 1962 (Ex. 3) does not contain a projection of cash available for distribution because the SEC advised the Corporation to discontinue its practice of making such projections (Ex. 9, pp. 77-78). However, the Corporation's third prospectus dated June, 1962 states (again taking into account the waivers of certain payments by defendants Wolf, Eckhaus and Spilky) that the "cash available for distributions for the period from January 16, 1961 to March 31, 1962 inclusive (after payments of $298,814 required for mortgage

amortization) amounted to $529,146" and that "[t]he aggregate of cash distributions to stockholders was $517,766" (Ex. 3, p. 9). The Corporation's third prospectus dated June, 1962 further states that, "while there is no assurance that the Company will continue to make distributions, the Company believes that the continued payment of distributions at the rate of 96¢ per share per year may continue to be paid out of operations, and a distribution of 30¢ per share, if available, may be paid to the holders of Class B Common Stock" (Ex. 3, p. 8).

The actual fact, according to plaintiff, was that the Corporation, ever since the commencement of its operations in June, 1961, had been paying distributions to stockholders which were substantially in excess of the cash actually available for distribution. This is shown by a work sheet prepared by the Corporation's comptroller, setting forth the Corporation's cash position on a monthly basis (Ex. 7). This work sheet was introduced before the SEC.

The work sheet shows monthly cash shortages (i.e., excess of cash payments (including distributions to stockholders) over cash receipts) during the period June, 1961 through December, 1961 ranging from $27,000 to $62,000 (Ex. 7). As of the end of December, 1961, the cumulative cash shortage for the first six months of operations was $161,558, according to the work sheet (Ex. 7).

Notwithstanding such cash shortages, as is further shown in the work sheet, the Corporation (by increasing in January, 1962 the rate of its cash distributions from 7¢ per month to 8¢ per month) increased its cash distributions to stockholders from the sum of $54,992 per month to $62,768 per month (Ex. 7). As of the end of June, 1962, the cumulative cash shortage was $291,784, according to the work sheet (Ex. 7).

The Tidelands Rent

As stated, the essence of the complaint is contained in paragraph 7(a) which alleges that the Corporation's pro-

spectuses failed to disclose that the Corporation's cash distributions to stockholders substantially exceeded the cash actually available for distribution. As also stated, the remainder of paragraph 7 is basically particularization, that is, the detailed respects in which the amounts of cash stated in the Corporation's prospectuses to be available for distribution to stockholders were misleading.

Paragraphs 7(b) through 7(g) of the complaint relate to the Tidelands Motel in Tucson, Arizona (6a-7a). The limited partnership, the Tucson, Motel Co., which was organized on March 1, 1960 (Ex. 1 (June, 1961 P.), p. 12), owned the Tidelands Motel (Ex. 2 (January, 1962 P.), p. 28). The motel was leased to Morin Scott, d/b/a Tidelands, for a net annual rental of $187,000 (Ex. 2, p. 28). Scott, as lessee, was required to pay certain additional expenses, including real estate taxes, which in 1962 ran to about $26,400 a year (approximately $2,205.00 monthly) (Ex. 5 (settlement stipulation), p. 9). The interests of the limited partners in the Tucson Motel Co. were acquired by the Corporation in the June, 1961 exchange offering (Ex. 2, p. 3).

In December, 1960, the lessee of Tidelands, Morin Scott, borrowed $25,000 from a bank on a 90-day note personally endorsed by the defendant Joseph Wolf (Ex. 5, p. 16). The proceeds of this loan were used to pay rent that Scott owed Tucson Co. upon the Tidelands Motel, which was not generating enough cash to pay its rental (Ex. 5, p. 16).

Also in December, 1960, one Joseph Levin (a business associate of defendants Wolf, Eckhaus and Spilky) borrowed $56,000 from the Mayflower of Atlantic City, Inc., the operating lessee of the Mayflower Hotel, Mayflower of Atlantic City, Inc. being one of the interests which the Corporation had acquired upon its formation in January, 1961 (Ex. 5, p. 16). Levin used $24,000 of this money towards the retirement of Scott's $25,000 bank loan, on which, as noted, Joseph Wolf was a personal endorser (Ex. 5, p. 16). In addition, Levin advanced $20,000 on

April 30, 1961 and $12,000 on May 18, 1961 to Tucson Co. in partial payment of Scott's rental obligations to Tucson Co. for the months of May and June, 1961 (Ex. 5, p. 16).

Thus, prior to the Corporation's first public offering in June, 1961, a business associate (Levin) of defendant Joseph Wolf had borrowed $56,000 from one of the Corporation's subsidiaries in order to enable Scott to pay the rent which he owed to Tucson Co. upon the Tidelands Motel. In addition, Levin had used part of this $56,000 to pay off a bank loan which Scott had incurred to pay the rent on Tidelands to Tucson Co. and on which bank loan defendant Joseph Wolf was personally liable as an endorser.

On October 18, 1961, the Corporation paid Levin $56,000 and recorded the transaction on its books as a rent receivable of $56,000 due from Scott (Ex. 5, p. 17). None of these facts was set forth in any of the Corporation's prospectuses.

The arrearages of Scott on the Tidelands Motel mounted steadily until they reached the massive sum of $180,907 (almost a full year's rent) as of March 31, 1962 (Ex. 3 (June, 1962 P.), p. 42, note 3). On February 1, 1963 when the arrearages had increased to $283,301, the Corporation sold Tidelands to Scott for a 3% purchase money third mortgage and a cash payment of only $50,000 (Ex. 6 (SEC's decision), p. 5, footnote 9). However, Scott fell behind on his mortgage payments and the Corporation repossessed Tidelands in October, 1964 and leased it to a new tenant at an appreciably lower rent (*Ibid.*).

The Arnold Constable Receivable

The Corporation acquired the leasehold of the 10 East Fortieth Street Building in Manhattan in the June, 1961 exchange offering (Ex. 2 (January, 1962 P.), p. 3). Arnold Constable & Co. was the major tenant of 10 East Fortieth Street and the lease of Arnold Constable called for an

annual rental in excess of $200,000 (Ex. 1 (June, 1961 P.), p. 34; Ex. 5 (settlement stipulation), p. 11). Under its lease, which was first made in 1930, Arnold Constable was required to pay certain rent increases to correspond to the increases in the real estate taxes since 1930 (Ex. 5, p. 11; Ex. 6 (SEC's decision), p. 5).

The amount of the rent increases payable by Arnold Constable under its lease had been in dispute ever since at least 1956 and Arnold Constable paid only a portion of the increases in taxes for which it had been billed by the Corporation since 1956 (Ex. 5, p. 11). Upon defendant David Berdon's audit of the Corporation, Arnold Constable refused David Berdon's request to confirm the receivable of $24,898 shown by the Corporation on its books for Arnold Constable (Ex. 5, p. 12). The Corporation had no intention of bringing legal proceedings against Arnold Constable to collect the amount in dispute between them because the Corporation did not want to jeopardize its relations with Arnold Constable over this relatively small amount (Ex. 6, pp. 5-6). In addition, the whole amount of $24,898 in dispute for the entire six years was included in cash available for distribution (Ex. 6, p. 6) when, at most, plaintiff claims, only one year's arrearages should have been so included even assuming the collectibility of the receivable. (In March, 1963, after the SEC's stop order proceeding was instituted, the Corporation collected the Arnold Constable receivable (Ex. 6, p. 6, footnote 13).)

The Palm Beach Spa Receivable

One of the properties acquired by the Corporation upon its organization in January, 1961 was the Mayflower Hotel and Lake Trail Apartments in Palm Beach, Florida (Ex. 1 (June, 1961 P.), p. 4). This property, before deducting any charge before depreciation, either operated at a loss or about broke even (Ex. 1, p. 27).

On June 20, 1961, the Corporation leased the property to one Larry Paskow, d/b/a the Palm Beach Spa, Inc., at a net annual rental of $130,000 (Ex. 2 (January, 1962 P.), p. 18; Ex. 3 (June, 1962 P.), p. 47). The monthly rentals were payable on the basis of the seasonal nature of the business instead of in equal installments, the season running from about the middle of December through about the end of March (Ex. 3, p. 47).

Under its lease with Paskow, the Corporation agreed to advance Paskow the sum of $200,000 to renovate the property (Ex. 2, p. 18). In the 1961-62 season running from December 16, 1961 to March 31, 1962, the Palm Beach Spa lost $93,536 before any charges for depreciaiton or for the rent payable to the Corporation (Ex. 5 (settlement stipulation), p. 15). The Palm Beach Spa closed for the season on April 1, 1962 (*Ibid.*).

In January, 1962, the Corporation purchased a 50% interest in Palm Beach Spa, Inc. for $1,000 (Ex. 2, p. 18). At that time, Palm Beach Spa, Inc. had a negative book value and was indebted to the Corporation in the total sum of $237,500 (Ex. 6 (SEC's decision), p. 6, footnote 15). On January 19, 1962 and on February 8, 1962, the Corporation advanced to Palm Beach Spa, Inc. the additional sums of $75,000 and $20,000, respectively, to cover the Spa's operating losses (Ex. 5, p. 15).

In June, 1963, Spa's lease was cancelled; Spa was still insolvent and the Corporation had to write off its entire investment in Spa; the property was leased to a new operator at a reduced rental; and, in addition, in order to permit the new lessee to establish trade credit and in order to protect its own credit standing, the Corporation paid, at its own expense, Spa's unsatisfied creditors (Ex. 6, p. 6, footnote 15).

The Overstatement of Income From the Minority Interests

In the June, 1961 exchange offering, the Corporation acquired minority interests in the limited partnerships of 635 Madison Avenue Co. and 147 East 44th Street Co. in Manhattan (Ex. 2 (January, 1962 P.), pp. 3, 23). In computing the sum of $529,146 shown in the June, 1962 prospectus as the amount of cash available for distribution to stockholders for the period from January 16, 1961 to March 31, 1962 (Ex. 3 (June, 1962 P), p. 9), the Corporation included $137,845 of income from its minority interests in these two partnerships (Ex. 5 (settlement stipulation), p. 13). However, this figure overstated by $37,018 the Corporation's income in respect of these minority interests because no deduction had been made for the Corporation's proportionate share of the two partnerships' mortgage amortization payments (Ex. 5, p. 14).

This mistake was discovered by George Greenberg of David Berdon on June 13, 1962 (*Ibid.*). In its decision herein, the SEC pointedly stated that, "[w]ithout deciding the point, we assume that this overstatement was an inadvertent error" (Ex. 6, p. 6, footnote 16).

In his hearing testimony before the SEC, George Greenberg testified that on June 13, 1962 he discovered that he had failed to deduct these mortgage payments in the sum of $37,000; that he conferred that same day with defendants Joseph Wolf, Eckhaus and Spilky concerning this mistake; but that, however, this mistake was not reported to the SEC (with which the Corporation had filed an amendment to its second registration statement on June 1, 1962) (Ex. 12).

The Gwynne Receivable

The Gwynne Building in Cincinnati, Ohio was another property which the Corporation acquired in its June, 1961

exchange offering (Ex. 2 (January, 1962 P), p. 3). The building was net leased to the Gwynne Corporation at a net annual rental of $248,000 payable in equal monthly installments (Ex. 1 (June, 1961 P), p. 37).

The rental payments of the Gwynne Corporation for the months of October, November and December, 1961 and January, 1962 were short $3,000 for each month (Ex. 5 (settlement stipulation), p. 12). The rate of occupancy for the Gwynne Building had been in a state of decline, as follows: 95% for 1958; 98% for 1959; 90% for 1960; and 87% for the first 10 months of 1961 (Ex. 3 (June, 1962 P), p. 63).

Prior to March 31, 1962, the lease on the Gwynne Building was assigned to a new tenant, the Natjan Realty Corporation (Ex. 5, p. 13). Defendant David Berdon caused a letter to be mailed to Natjan asking Natjan to confirm the receivable for the unpaid rent (*ibid.*). However, Natjan was not legally liable for the arrearages which arose before it became tenant (*ibid.*).

In March, 1963, after institution of the SEC's proceeding, the Corporation collected the $12,000 arrearage (Ex. 6 (SEC's decision), p. 5, footnote 10). However, new arrearages soon arose which exceeded $30,000 by the end of 1963, increased to $46,313 by March 31, 1964, and reached $70,788 by September 30, 1964 (*Ibid.*).

Recapitulation

The detailed respects in which the cash available for distribution to stockholders was overstated in each of the Corporation's three prospectuses may be shown in tabular form, as follows:

Overstatement	*June, 1961 P*	*January, 1962 P*	*June, 1962 P*
Tidelands	$187,000	$187,000	$225,958
Arnold Constable	28,366	30,059	24,898
Palm Beach	0,000	65,000	65,000
Gwynne	0,000	12,000	12,000
Minority Income	0,000	49,357	37,018
(a) Total Overstatement	215,366	343,416	364,874
(b) Claimed Cash Available	524,631	755,262	529,146
% of (a) to (b)	41.1%	45.5%	69%
(c) Cash Distributions	524,631	755,262	755,262

The figure of $187,000 for Tidelands represents the annual rent payable upon the Tidelands Motel to Tucson Co., it being plaintiff's contention, as noted, that this rental obligation, for all practical purposes, was worthless. As also noted, the June, 1962 prospectus sets forth the cash available for distribution (529,146) in the period from January 16, 1961 to March 31, 1962. This is a period of about 14½ months, during which the rental upon Tidelands would total about $225,958.

The figures for the Arnold Constable receivable are taken at the amounts set forth for the most recent dates in the respective prospectuses (Ex. 1, p. 62, note H; Ex. 2, p. 56, note 2; Ex. 3, 59). As noted, the amount of the Palm Beach Spa receivable included in cash available for distribution in the June, 1962 prospectus was $65,000 (this being the Corporation's one-half share, as 50% owner, of the annual rental of $135,000). The rental for Palm Beach Spa was also included in cash available for distribution in the January, 1962 prospectus (Ex. 2, p. 14, note (A)); presumably, the same amount of $65,000 was included.

As of the commencement of January, 1962, the Gwynne receivable, as noted, was $12,000. Respecting the overstatement of income from minority interests, this was, as

also noted, $37,018 for the period from January 16, 1961 to March 31, 1962. Since the Corporation did not commence operations until June, 1961, presumably the overstatement of $37,018 is for only a nine month period and presumably also the overstatement for a full annual period, as in the January, 1962 prospectus, would be correspondingly larger.

POINT I

Defendants' claim that there is a conflict of interest precluding a class action because plaintiff "may not be motivated" to prove deficiencies in all three prospectuses (a) is not only entirely speculative but (b) such claim is interlocutory and (c), moreover, was not even made below.

A.

Defendants ask the Court to take this case because of an asserted conflict in interest between plaintiff and certain members of the class for whom he is suing. The speculative nature of this asserted conflict in nature is manifest. Thus, defendants say that the "economies of prosecution *may dictate* a heavy concentration on the second and third prospectuses and a cursory preparation in respect of the first" (Pet., p. 15; italics supplied), because assertedly it will be easier for plaintiff to prove any deficiences in the second and third prospectuses than in the first. Again, plaintiff "*may not be motivated* to conduct arduous discovery and trial proceedings with respect to the significantly different issues involved in respect of the first prospectus" (Pet., p. 20; italics supplied).

Having bottomed their petition upon the entirely conjectural claim of conflict (which is without any basis whatever in the record, Point II, *infra*), defendants proceed to pile speculation upon speculation. Thus, defendants ask rhetorically, "How, for example, will a district judge know

whether plaintiff's counsel is directing the thrust of his discovery proceedings to favor certain issues . . ." (Pet., p. 23; italics supplied). Again, "[*i*]*t is doubtful,* however, that a trial court could by later order reverse the prejudice that has resulted from the activities of an inadequate representative" (Pet., p. 24); that "[i]f the determinations required under Rule 23 are not made at the outset, after hearing as we suggest . . ., the proper determinations *more probably than not* never will be made" (Pet., pp. 24-25); and that "[*i*]*f,* as a result of such a [class] notice, a member of the class misconceives the adequacy of representation and remains silent, and no person representative of his class' interest comes forward [then, in that event, and assuming still further that there is passive acquiescence by the District Court], the members of that class *may be prejudiced* and yet be bound by the result of the lawsuit carried forward by the inadequate representative" (Pet., p. 27) (italics supplied).

(Defendants say, "only a 'Rule 2' judge [i.e., a judge to whom the case is assigned for all purposes] could hope to have, and maintain, the familiarity with a class suit as to have a chance 'efficiently and fairly' to manage it" (Pet., p. 23). Plaintiff has in fact applied in the District Court for a Rule 2 judge; however, *defendants* have opposed plaintiff's motion, presently pending in the District Court, stating in an affidavit by one of defendants' counsel that "the issues herein are uncomplicated and will not involve a trial of undue complexity".)

B.

The order sustaining the class action is of course interlocutory. This Court does not sit to review interlocutory orders in the absence of exception-circumstances. "As has been many times declared, this is a jurisdiction to be exercised sparingly, and only in cases of peculiar gravity and general importance, or in order to secure

uniformity of decision." *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U. S. 251, 258. One of the underlying reasons for this policy is that subsequent events in the case may make the non-final order, or the objectionable parts thereof, moot.

Such rationale is singularly apposite here. To confirm this, one need go no further than Federal Rule 23 itself, which specifically provides that "an order [respecting the maintainability of the class action] may be conditional and may be altered or amended before the decision on the merits" [subdivision (c)(1)]; that the class "notice shall advise each member that . . . the court will exclude him from the class if he so requests" [(c)(2)(A)]; that "any member who does not request exclusion may, if he desires, enter an appearance through his counsel" [(c)(2)(C)]; that "an action may be brought or maintained as a class action with respect to particular issues" [(c)(4)(A)]; that "a class may be divided into subclasses and each subclass treated as a class [(c)(4)(A)]; that "the court may make appropriate orders . . . requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given . . . of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action" [(d)(2)]; that such "orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time" [(d)(5)]; and, finally, that a "class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class . . ." [(e)]. Defendants' contention that that District Court, armed with the broad and flexible powers conferred by Rule 23, may not be able to manage this class action because of the possibility of certain motivations is nothing more than chimerical.

C.

As the capstone, defendants did not even make their present contention of a conflict in interest to the court below. There is nothing whatever in defendants' papers below that adverts to a conflict in interest or to the necessity of a hearing to determine the existence of such claimed conflict or, for that matter, to the necessity of any hearing at all.

What defendants did argue below was that this action did not involve the requisite commonality of questions to be maintainable as a class action. This is of course a far different question from defendants' present claim of a conflict of interest, notwithstanding that one of the subsumptions of such claim is a lack of commonality.

The court below did state in the course of its opinion, "We do not perceive, at this juncture of the case any conflict of interest between Green and other members of the class." (Pet. p. A2) This is the only reference by the court below to the question of conflict. This reference was made *sua sponte* by the court below in the course of a *seriatim* discussion of the respective requirements of Federal Rule 23. Such passing and *sua sponte* reference to the question of conflict does not of course constitute a decision on the particular objections now made in this respect by defendants for the first time.

POINT II

In any event, defendants' claim that there is a conflict in interest because plaintiff "may not be motivated" to prove deficiencies in all three prospectuses is without merit since (a) persons excluded from the instant class will not receive any representation at all in that the statute of limitations has otherwise run and (b) defendants' claim of a conflict is without any basis whatever in the record.

A.

Defendants despair at length over the possibility that some members of the class may receive something less than the most arduous representation. Defendants omit to say that, if any members of the class are excluded from this class action, their claims will be entirely barred, and they will be beyond the possibility of any representation at all, because the statute of limitations has otherwise run.

As the court below stated, "it should be noted that Green [plaintiff] was the only individual to bring suit before the Statute of Limitations barred other actions based on the alleged misrepresentations". (Pet. p. A12) Consequently, as the court below further stated, "to deny a class action under such circumstances would have serious consequences, since all those injured except Green would now have no other remedy, although they may have been relying on Green's class action for their balm" (Pet., p. A18, footnote).

B.

As noted, defendants' contention of a conflict in interest subsumes a lack of commonality of questions as between the three prospectuses. Plaintiff claims the existence of five overstatements of cash and the distribution of these overstatements as between the three prospectuses is shown in the table set forth at page 17, *supra.*

The foregoing table shows that all five overstatements of cash are contained not only in the third but also the second prospectus. Two of the five, including the massive Tidelands item, are contained in all three prospectuses.

The massive Tidelands rental of $187,000 per year is obviously the critical item. Prior to the Corporations first public offering in June, 1961, defendant Joseph Wolf and one of the Corporation's subsidiaries had secretly lent $56,000 to Tidelands to enable Tidelands to pay its rent (*supra,* pp. 11-12).

Defendants blandly say that, "On June 1, 1961, at about the date of the first prospectus, the Tidelands rent allegedly was in arrears to the extent of $1,083, less than one month's rent and the last installment of its tax bill, $14,144, had not been paid" (Pet., p. 17). This ignores the secret loans to Tidelands in the total sum of $56,000 made in order to keep Tidelands afloat. Plaintiff's contention is that Tidelands' rental obligation of $187,000 was worthless for all practical purposes.

Since the third prospectus contains all five overstatements of cash and since plaintiff purchased his stock after the third prospectus, proof of plaintiff's individual case involves proof of all of the five specific respects in which the prospectuses overstated cash. Moreover, since plaintiff purchased his stock in the open market within two weeks of the third prospectus dated June 1, 1962 and since the three prospectuses were issued in quick succession (i.e., within six months of each other) in the period of one year, it is impossible to ascertain where the manipulative effect of one prospectus entirely leaves off and where the other exclusively picks up. The manifest fact is that these three prospectuses had a cumulative, manipulative impact on the market price of the Corporation's securities and that plaintiff purchased his stock subject to the cumulative, manipulative impact of the three prospectuses. Hence, the three prospectuses herein, not only in their impact upon

market price but also in their underlying data, are "interrelated, interdependent and cumulative", being, in this respect, like "standing dominoes". *Fischer* v. *Kletz,* 41 F.R.D. 337, 381 (S.D.N.Y. 1966).

Further, the first prospectus is a highly significant, if not the most significant, prospectus in respect of damages. The first prospectus is the only prospectus pursuant to which the Corporation sold any securities for a monetary consideration ($600,000 of common stock). In addition to those persons who purchased the $600,000 of common stock in the distribution covered by the first prospectus, the class comprises those persons who purchased the Corporation's securities thereafter in the open market and no estimate of damages can be made by plaintiff for the latter group since figures are not published for the volume of trading in over-the-counter securities. Significantly, it is the first prospectus at which defendants are taking dead aim in their instant petition for certiorari and defendants seek in this Court to whittle away the first prospectus from the class action.

Defendants further say the court below erred in not directing a hearing as to the "consequences of the conflicts" and "the extent to which plaintiff or the defendants are correct in their respective contentions as to whether issues are common or not" (Pet., p. 27). In view of its chimerical nature, it is difficult to see how there could be any kind of meaningful hearing as to defendants' claim of conflict.

As to the question who is right—plaintiff or defendants —as to the commonality of questions as between the three prospectuses, defendants' version of the distribution of the alleged overstatements as between the three prospectuses is not based upon any independent evidence submitted by defendants upon the instant motion, because defendants submitted none whatsoever. Rather defendants' claim in this respect is based upon defendants' reading—dis-

puted by plaintiff—of the deposition of plaintiff's counsel (Pet., pp. 10-11). Certainly, no hearing is required to determine whose reading of the deposition is correct, particularly since such testimony is in any event subject to amendment because it does no more than set forth plaintiff's contentions in this case respecting the prospectuses.

Further, it is patent that the issue of whether or not a preliminary hearing is required in class actions and, if so, when and as to what questions (the merits as in *Doglow* v. *Anderson,* 43 F.R.D. 472 (E.D.N.Y. 1968), where plaintiff's claims of market manipulation appeared to be flamboyant upon their face, or the practicality of a class action as in *Eisen* v. *Carlisle & Jacquelin,* 391 F. 2d 555 (2nd Cir. 1968), where a class antitrust action was brought on behalf of all odd-lot buyers and sellers during 1960-1966, a class consisting of 3,750,000 individuals and corporations) involves preeminently the exercise of discretion in light of the attendant circumstances, and is not subject to flat rule or to review by this Court except for an abuse of such discretion. And whether or not there has been a proper exercise of such discretion in any particular set of circumstances is, relative to this Court's jurisdiction, a very small practice point, entirely apart from the fact that the decision by the court below not to direct a hearing upon remand plainly did not constitute any abuse of discretion.

Finally, defendants in their petition (p. 18) make subordinate claims of certain other conflicts, such as a claimed conflict between sellers and holders of the Corporation's securities and also between shareholders and debentureholders. Even under defendants' view, there is no conflict in respect of proving defendants' liability and the conflict claimed to exist in respect of damages is again chimerical. (The District Court, which decided in *Herbst* v. *Able,* 45 F.R.D. 451 (S.D.N.Y. 1968) to conduct a preliminary hearing to determine whether a holder could ade-

quately represent a seller decided, after hearing, upon general grounds not peculiar to that case, that "any conflicts of interest between members of the purported class are more academic than real." See CCH Federal Securities Law Reporter, Current Volume, Par. 92, 368, p. 97, 761. In the instant case, plaintiff sold his stock for a loss after the commencement of the instant action.)

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for certiorari should be denied.

Respectfully submitted,

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of Counsel:

MALCHMAN & KLIED.

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